

## Franchise Tax Board

## ANALYSIS OF ORIGINAL BILL

Author: Bates Analyst: Marion Mann DeJong Bill Number: AB 2347  
Related Bills: See Legislative History Telephone: 845-6979 Introduced Date: 02/24/2000  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Revise 540EZ

SUMMARY

This bill would allow specified taxpayers to file a revised Form 540EZ. The revised Form 540EZ would provide a new method for computing income taxes. Tax would be calculated by taking "total tax" (as defined), subtracting a standard deduction (as defined), and multiplying by 2.5%.

According to the author's staff, this is a "spot bill." The author intends to amend the bill to require the department to create a simplified tax form for seniors.

This analysis briefly discusses the bill as introduced. If the author moves the bill without amending it, a more thorough analysis with additional concerns, costs and revenue will be provided.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and would apply to taxable years beginning on or after January 1, 2000. This bill would impact the 2000 Form 540EZ that is filed in 2001.

SPECIFIC FINDINGS

**Current state law** requires individuals to file a tax return if their adjusted gross income from all sources exceeds \$8,719 (\$17,438 married) or if their gross income from all sources exceeds \$10,889 (\$21,798 married). These threshold amounts are increased for individuals 65 or older and/or individuals with dependents.

**Current state law** provides six personal income tax rate brackets ranging from 1% to 9.3%.

**Current state law** allows taxpayers the option of itemizing their deductions or claiming a standard deduction. The standard deduction amounts for 1999 are \$2,711 for single or married filing separate returns and \$5,422 for married filing joint return, head of household and qualified widow(er).

**Current state law** provides credits against the tax for personal and dependent exemptions. The 1999 credit amounts are \$72 for single, married filing separate returns and head of household, \$144 for married filing joint, and \$277 for each dependent. Additional exemption credits of \$72 each are allowed for persons who are blind or age 65 or older.

## Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <u>X</u> PENDING

## Department Director

## Date

Alan Hunter for GHG

3/28/00

**Current state law** requires the Franchise Tax Board (FTB) to prepare and distribute blank forms for the returns, declarations, statements, or other documents. FTB is required by law to make available to taxpayers tax forms that are as simple as possible for taxpayers to prepare. FTB is required to make every effort to ease taxpayers' compliance burden by at least (1) designing forms so that amounts already entered on the federal return may be copied to the state form, (2) allowing federal schedules to be attached to the state return, and (3) choosing general form designs (e.g., paper weight and quality, ink color) that facilitate the preparation of the state return.

FTB provides a variety of tax forms for Personal Income Tax (PIT) taxpayers; Form 540, Form 540NR, Form 540A, Form 540EZ and Form 540 2EZ. The form that a taxpayer should use is determined by several factors, including filing status, dependents, amount and sources of income and deductions.

**Form 540EZ** was designed for single or married taxpayers that have no dependents. Qualified taxpayers can file Form 540EZ as a conventional paper return or as an electronically filed return. Taxpayers must meet the following criteria to use Form **540EZ**:

- Ⓟ Taxable income of \$50,000 or less;
- Ⓟ Cannot use Married Filing Separate filing status;
- Ⓟ Income only from wages, salaries, tips, taxable scholarships or fellowship grants, unemployment compensation and interest;
- Ⓟ Interest income of \$400 or less;
- Ⓟ Under age 65 on December 31, 1999;
- Ⓟ Not blind on December 31, 1999;
- Ⓟ Cannot have dependents;
- Ⓟ Claiming standard deduction instead of itemized deductions for California;
- Ⓟ Withholding on Form(s) W-2 is the only prepayment of tax made; and
- Ⓟ No adjustments to income such as an IRA deduction or a student loan interest deduction.

This year FTB introduced a new form. **Form 540 2EZ** was designed to simplify filing for taxpayers whose only source of income is from wages, salaries, tips or interest, and who are basically filing to receive a refund of their withholding.

Qualified taxpayers can file Form 540 2EZ as a conventional paper return or as an electronically filed return. As a paper form, the 5.5 X 8.5-inch Form 540 2EZ is smaller than a normal full-size 8.5 X 11-inch return and is printed on stiff cardstock-type paper. Form instructions include special tax tables that have the standard deduction and personal and dependent exemption credits built in, leaving fewer math operations for the taxpayer to perform. The form comes with its own pre-addressed envelope.

As an electronic form, Form 540 2EZ may be filled in and filed on-line via certain on-line filing companies. As part of the e-Filing transaction, the on-line company will provide a final hardcopy of the return to the taxpayer. Some on-line filing companies are offering no cost tax preparation and electronic filing for 540 2EZ filers. The names of these companies and links to their web sites are available on FTB's web site ([www.ftb.ca.gov](http://www.ftb.ca.gov)).

Taxpayers must meet the following criteria to use **Form 540 2EZ**:

- ⌚ Gross income of \$50,000 or less for Single and Head of Household filing status;
- ⌚ Gross income of \$100,000 or less for Married Filing Joint and Qualifying Widow(er) filing status;
- ⌚ Cannot use Married Filing Separate filing status;
- ⌚ Income only from wages, salaries, tips, and interest;
- ⌚ Interest income of \$400 or less;
- ⌚ Cannot be claimed as a dependent by another taxpayer;
- ⌚ Under age 65 on December 31, 1999;
- ⌚ Not blind on December 31, 1999;
- ⌚ Entitled to claim 0-3 dependents;
- ⌚ Claiming standard deduction instead of itemized deductions for California;
- ⌚ Withholding on Form(s) W-2 is the only prepayment of tax made; and
- ⌚ No adjustments to income such as an IRA deduction or a student loan interest deduction.

**This bill** would allow single taxpayers whose "total income" is \$50,000 or less and married taxpayers whose "total income" is \$100,000 or less to file a revised Form 540EZ. Taxpayers that use the revised Form 540EZ would be taxed only on specified income, be allowed a standard deduction, and be taxed at a rate of 2.5%.

For purposes of the revised Form 540EZ, "total income" would be wages, salaries, tips, dividends, interest and pension income. The taxpayers could subtract a standard deduction from the "total income." The standard deduction would be equal to the minimum wage multiplied by 1040. Since the bill does not specify federal or California minimum wage, the standard deduction would be \$5,356 or \$5,980 depending on whether the federal (\$5.15) or California (\$5.75) minimum wage amounts were used.

#### Policy Considerations

According to the author's staff, the author intends to amend this bill to require the department to create a simplified tax form for seniors. Legislation is not needed to accomplish this goal. Current state law allows FTB to design forms that ease taxpayer compliance.

Further, FTB is committed to simplifying the ways Californians file and pay their taxes. By constantly improving our filing systems, such as adding programs like Internet filing, electronic filing, Telefile, simpler paper returns like the Form 540 2EZ and a variety of scanning options, FTB helps individuals file their tax returns faster and better. Department staff is available to explore ideas for simpler forms, new forms and methods of filing.

#### Implementation Considerations

This bill would raise the following implementation considerations. According to the author, this bill will be substantially amended. Department staff is working with the author to achieve her goals.

- ⌚ Since the revised Form 540EZ would basically create a new tax system, the department would need to substantially revise most processes and systems to implement this bill.

- ⌚ This bill would create a new tax rate, standard deduction and definition of taxable income for taxpayers with specified income amounts. This would create inequities for taxpayers who do not meet the requirements of this bill. If taxpayers perceive the tax system to be unfair, voluntary compliance is threatened. For example, Taxpayer A is a single taxpayer with \$50,000 of income from wages. Taxpayer B is a single taxpayer with \$50,001 income from wages. Taxpayer A could file the revised Form 540EZ, reporting \$50,000 of income, subtract the new standard deduction (\$5,356 assuming the federal minimum wage is used) and have a \$1,116 tax liability (\$44,644 x 2.5%). Taxpayer B could not file the revised Form 540EZ because his total income exceeded the \$50,000 limit. Taxpayer B's standard deduction would be \$2,711, and he would be allowed a personal exemption credit of \$72. Taxpayer B would have a tax liability of \$2,635.
- ⌚ Taxpayers would likely be confused by the differences in the tax system that this bill would create. Taxpayer inquiries would likely increase as well as taxpayer mistakes.
- ⌚ It is unclear whether the federal or California minimum wage should be used to determine the minimum wage. It also unclear how to determine the standard deduction when the minimum wage amount changes during the taxable year. Additionally, it is unclear whether "minimum wage" means the hourly wage rate or the annual minimum wage amount.

#### FISCAL IMPACT

##### Departmental Costs

Since the author has indicated that the bill will be substantially amended, departmental costs will not be provided at this time. If the bill moves forward without being amended, costs will be provided.

##### Tax Revenue Estimate

Since the author has indicated that the bill will be substantially amended, a tax revenue estimate will not be provided at this time. If the bill moves forward without being amended, questions regarding how this bill would impact the current tax structure would need to be answered before a revenue estimate could be provided.

#### BOARD POSITION

Pending.